BAD FAITH LAW IN INDIANA

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I. OVERVIEW OF INDIANA BAD FAITH LAW

Indiana recognizes a common-law cause of action for bad faith in the handling and/or settlement of an insurance claim. Under Indiana law, an insurer has a legal duty, implied in all insurance contracts, to deal in good faith with its insured. *Freidline v. Shelby Ins. Co.*, 774 N.E.2d 37 (Ind. 2002). Although the Indiana Administrative Code sets forth examples of unfair claim settlement practices, the Administrative Code does not provide a private cause of action for an insured based on violations of those examples. Likewise, Indiana does not recognize any cause of action for "third-party" bad faith. The sole statutory cause of action for bad faith in Indiana arises in the workers' compensation context.

A. Common Law

The modern trend of bad faith law in Indiana was discussed by the Supreme Court in the case of *Erie Ins. Co. v. Hickman* in 1993. In *Hickman*, the Court discussed the "special relationship" between the insurer and its insured, and determined implied in every insurance contract is a duty to deal in good faith with the insured. The Court recognized an insurance carrier's failure to exercise good faith in the handling and/or settling of an insurance claim not only results in potential harm to the insured, but also advances the public interest of fair play between an insurer and an insured. Although not an exhaustive listing, the *Hickman* court set forth general examples of conduct an insurer must refrain from:

1. Making an unfounded refusal to pay policy proceeds;
2. Causing an unfounded delay in making payment;
3. Deceiving the insured; and
4. Exercising an unfair advantage in an attempt to pressure an insured into a settlement of a claim.

Id. at 519.

Alternatively, the *Hickman* court further recognized every insurance company does have a right, in good faith, to dispute claims. Even an erroneous denial of an insurance claim or a lack of diligent investigation, standing alone, is **not** sufficient under Indiana law to establish a breach of the insurance company's duty of good faith. *Id.* at 520. Rather, liability for bad faith arises where there is no rational or principled basis for denial of the claim under the terms and conditions of the insurance policy.

1. Elements of Proof

Although the tort of bad faith is fully recognized in the state of Indiana, there is a heightened burden of proof on a plaintiff pursuing a bad faith claim versus that in many other jurisdictions. Specifically, Indiana requires more than a mere preponderance of the evidence to sustain a claim of bad faith. Rather, the insured must present evidence that reaches the level of "clear and convincing" in nature. *Freidline v. Shelby Ins. Co., supra*. Generally, Indiana courts require an element of "conscious wrongdoing" to sustain a claim of bad faith. *Hoosier Ins. Co. v. Audiology Foundation of Am.,* 745 N.E.2d 300 (Ind. Ct. App. 2001). The following are examples of instances recognized as not rising to the level of bad faith in Indiana:

1. A good faith dispute regarding the amount of a valid claim, or whether the insured has a valid claim at all does not constitute bad faith, even if it is determined the insurer breached the insurance contract. *Hoosier Ins. Co. v. Audiology Foundation of Am., supra*;

2. An insurance company's incorrect interpretation of the law, alone, is not evidence of bad faith. *Eli Lilly & Co. v. Zurich,* 405 F.Supp.2d 948 (U.S.D. Ind. 2005);

3. An insurer's request for a second Examination Under Oath does not, in and of itself, constitute bad faith. *Nat'l Athletic Sportswear, Inc. v. Westfield Ins. Co.*, 528 F.3d 508 (7th Cir. 2008);

4. Poor judgment and/or negligence by the insurance carrier do not amount to bad faith. Rather, the finding of bad faith requires evidence of a state of mind reflecting dishonest purpose, moral obliquity, furtive design, or ill will. *Colley v. Indiana Farmers Mut. Ins. Group,* 691 N.E.2d 1259 (Ind. Ct. App. 1998).

B. Statutory Bad Faith in Workers' Compensation

Indiana Code 22-3-4-12.1 sets forth the sole context under which there may be a statutory cause of action for bad faith in the state of Indiana. Specifically, the statute provides:

> The worker's compensation board, upon hearing a claim for benefits, has exclusive jurisdiction to determine whether the employer, the employer's worker's compensation administrator, or the employer's worker's compensation insurance carrier has acted with a lack of diligence and bad faith, or has committed an independent tort in adjusting or settling the claim for compensation.

This statute has been ruled constitutional under Indiana law by the state's Supreme Court. *Sims v. U.S. Fid. & Guar. Co.*, 782 N.E.2d 345 (Ind. 2003). Generally, the same common law principles enumerated above should be applied by any insurance company handling worker's compensation claims in Indiana.

II. RECOVERABLE DAMAGES

A. Compensatory Damages

In addition to policy proceeds recoverable under an insurance contract, in the context of bad faith, an insured may also recover consequential damages in excess of the policy limits. *Rockford Mut. Ins. Co. v. Pirtle*, 911 N.E.2d 60 (Ind. Ct. App. 2009). Indiana recognizes the limits of an insurance policy definitively restrict the amount an insurer must pay in performance of the underlying contract, but do not limit the damages that are recoverable by an insured based on an insurer's breach of the insurance contract. *Id*. As Indiana law disfavors a windfall to any party, double recovery under a contractual and tort theory is not permitted for a single improper action. *INS Investigations Bureau v. Lee*, 784 N.E.2d 566 (Ind. Ct. App. 2003). Finally, although the issue has never been addressed by a state court in Indiana, a federal court applying Indiana law held an insured who is injured by the bad-faith conduct of an insurer was entitled to

recover damages, including emotional distress under traditional tort principles. *Patel v. United Fire & Cas. Co.*, 80 F.Supp.2d 948 (N.D. Ind. 2000).

B. Punitive Damages

While punitive damages are recognized as a recoverable element under Indiana law, mere proof the tort of bad faith was committed is not sufficient to establish the insured's right to recovery of punitive damages. *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515 (Ind. 1993). Rather, in order to recover punitive damages under Indiana law, an insured must prove by clear and convincing evidence the insurer acted with malice, fraud, gross negligence, or oppressiveness which did not result from a mistake of fact or law, honest error of judgment, overzealousness, mere negligence, or other human failing. *Id.*, and I.C. 34-51-3-2. Additionally, successful pursuit of compensatory damages is a pre-requisite to an award of punitive damages. *Crabtree v. Crabtree*, 837 N.E.2d 135 (Ind. 2005).

C. Damage Caps

Indiana statutorily limits an award of punitive damages to three times the plaintiff's compensatory damages or fifty thousand dollars ($50,000), whichever is greater. I.C. 34-51-3-4. It should also be noted under Indiana law, seventy-five percent (75%) of any punitive damage award must be shared with the state. Indiana's Punitive Damages Allocation Statute has been upheld as constitutional. *Cheatham v. Pohle*, 789 N.E.2d 467 (Ind. 2003).

D. Attorneys' Fees

Generally, Indiana follows the "American rule," that each party involved in litigation must pay its own attorneys' fees, and generally attorney fees are not recoverable absent a statute, contract, or stipulation dictating otherwise. Statutorily, Indiana allows recovery of attorney fees within the Court's discretion where there is a finding a party has litigated in bad faith. I.C. 34-

52-1-1. Pursuing frivolous or groundless litigation, where the primary purpose is to harass or maliciously injure an opposing party, or if the party's lawyer is unable to make a good faith and rational argument on the merits of the action, may give rise to the recovery of attorney fees. *Kuhn v. Cundiff*, 533 N.E.2d 165 (Ind. 1989).

III. OTHER PERTINENT INFORMATION

In evaluating a potential defense of a bad faith claim under Indiana law, the following factors and/or information must also be kept in mind:

1. The statute of limitations for a claim of bad faith is two years, but an insurance policy contractual limitation can validly shorten the timeframe. *Reveliotis v. State Farm Ins. Co.*, 2004 U.S. Dist. LEXIS 14115 (N.D. Ind. 2004);

2. Expert testimony is not required to establish a claim of bad faith;

3. Although not mandatory, Indiana courts have bifurcated bad faith from the underlying breach of contract claims pending a determination of coverage. *Ansert v. Adams*, 678 N.E.2d 839 (Ind. Ct. App. 1997);

4. "Advice of counsel" is a recognized defense to claims of bad faith under Indiana law. *Worth v. Tamarack Am.*, 47 F.Supp.2d 1087 (S.D. Ind. 1999).

IV. CONCLUSION

In Indiana, bad faith law is primarily a creature of common law. Although Indiana fully recognizes the tort of bad faith, unlike most other torts, proof of bad faith is required beyond a mere preponderance of the evidence. Indiana courts require "clear and convincing" evidence to establish both the elements of the bad faith claim, as well as a separate showing of "conscious wrongdoing" to recover punitive damages. While the state of Indiana is a favorable state in which to defend a bad faith claim, based on the heightened burden of proof and statutory cap on punitive damages, every reasonable step should be taken during the course of a claim investigation or settlement of a claim to complete a full, fair, and honest evaluation of the claim based on the totality of the information and evidence.